INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statutes and ruling involved	2
Statement	3
Reasons for granting the writ	8
Conclusion	9
Appendix A	10
Appendix B	31

CITATIONS

Cases:	
Baird v. *Commissioner*, 256 F. 2d 918, certiorari granted, 358 U.S. 918	8, 9
Commissioner v. *Burl P. Glover*, No. 381, this Term, certiorari granted, 358 U.S. 879	8
Commissioner v. *John R. Hansen and Shirley G. Hansen*, No. 380, this Term, certiorari granted, 358 U.S. 879	8, 9
Johnson v. *Commissioner*, 233 F. 2d 952	2
Schaeffer v. *Commissioner*, 258 F. 2d 861	9
United States v. *Hine Pontiac, et al.*, No. 561, this Term	9
Statutes:	
Internal Revenue Code of 1939:	
Sec. 22(a) (26 U.S.C. 1952 ed., Sec. 22(a))	2, 31
Sec. 41 (26 U.S.C. 1952 ed., Sec. 41)	2, 31
Sec. 42(a) (26 U.S.C. 1952 ed., Sec. 42(a))	2, 32
Miscellaneous:	
Rev. Rul. 57-2, 1957-1 Cum. Bull. 17	3, 32

In the Supreme Court of the United States

October Term, 1958

No. —

UNITED STATES OF AMERICA, PETITIONER

v.

COLONIAL CHEVROLET CORPORATION

No. —

UNITED STATES OF AMERICA, PETITIONER

v.

MARINE CHEVROLET CO., INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgments of the United States Court of Appeals for the Fourth Circuit in the above-entitled cases.[1]

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court in *United States* v. *Colonial Chevrolet*

[1] Pursuant to Rule 23(5) of the Revised Rules of this Court, this petition covers two cases decided by the United States Court of Appeals for the Fourth Circuit. Although separate judgments were entered, both cases involve substantially identical questions.

Corp. (Appendix A, *infra,* pp. 10–16) are not officially reported. The memorandum, findings of fact and conclusions of law of the District Court in *United States* v. *Marine Chevrolet Co.* (Appendix A, *infra,* pp. 18–27) are reported at 161 F. Supp. 62. The Court of Appeals did not write an opinion in either case.[2]

JURISDICTION

The judgment of the Court of Appeals in *United States* v. *Colonial Chevrolet Corp.* was entered on January 5, 1959 (Appendix A, *infra,* pp. 17–18); its judgment in *United States* v. *Marine Chevrolet Co., Inc.* was entered on December 12, 1958 (Appendix A, *infra,* pp. 29–30). The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether an accrual-basis taxpayer who sells property and receives part of his gain on the sale in cash and part in the form of a credit—the latter portion to be ultimately satisfied either by payment in cash or by offset against the taxpayer's obligations—is required to report the amount of gain so credited (as well as the gain in cash) as income for the year in which the credit is made.

STATUTES AND RULING INVOLVED

The statutory provisions involved are Sections 22(a), 41 and 42 of the Internal Revenue Code of 1939. Those sections, together with Rev. Rul. 57–2,

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[2] In each case, pursuant to motion or stipulation, judgment was entered by the court below in conformity with its decision in *Johnson* v. *Commissioner*, 233 F. 2d 952.

1957–1 Cum. Bull. 17, are set forth in Appendix B, *infra*, pp. 31–35.

STATEMENT

Colonial Chevrolet:

During the taxable years 1951–1954, inclusive, Colonial Chevrolet Corporation, an accrual-basis taxpayer, was engaged in selling new and used automobiles and trucks. It sold cars on credit and received conditional sales contracts from the purchasers to secure the deferred portion of the purchase price. Many of the conditional sales contracts were sold to two finance companies, General Motors Acceptance Corporation (GMAC) and the National Bank of Commerce of Norfolk, Virginia, pursuant to agreements between the taxpayer and the finance companies.[3] (Appendix A, *infra*, pp. 10–12; Colonial Chevrolet, Exs. 1, 2, 3 and 4.)

When a sale of an automobile was consummated, taxpayer transferred the conditional sales contract to GMAC, and received from the finance company an amount in cash equal to the deferred portion of the cash price of the car. A financing charge was also imposed in connection with each contract and included in the total amount the purchaser was obligated to pay. At the time each contract was acquired by the finance company, it credited to a reserve ac-

[3] A few contracts were also assigned to the Southern Bank of Norfolk in three of the taxable years, with that bank crediting a percentage of each contract to a non-interest bearing account in the taxpayer's name, on which taxpayer was unable to draw for 60 days after the credit was made. During the trial, taxpayer waived all claim for refund in respect to these amounts and no issue is presented here with respect to them. (Colonial Chevrolet Tr. 13–14.) "Tr. —" in this brief refers to the original transcript of record which is on file with this Court.

count maintained on its books in taxpayer's name a portion of the finance charge. During the taxable years any amount in the reserve in excess of 3% of all the outstanding paper was remitted to the taxpayer annually. (Appendix A, *infra*, pp. 11–13.)

The agreement between the taxpayer and the National Bank of Commerce of Norfolk had substantially the same terms, except that it provided for semi-annual remittances to the taxpayer of the excess over 3% of all the outstanding balances on contracts purchased by the bank from the taxpayer. (Colonial Chevrolet, Ex. 4.)

On audit of taxpayer's tax returns for the taxable years involved, the District Director of Internal Revenue at Richmond included in taxpayer's income, in addition to amounts taxpayer had reported in its returns, the following amounts, representing the net increase during the respective years in the reserve accounts maintained by the finance companies[4] (Appendix A, *infra*, pp. 13–14; Tr. 13–14):

Year ended January 31, 1951	$711.67
Year ended January 31, 1952	8,831.60
Year ended January 31, 1953	9,279.95
Year ended January 31, 1954	12,923.85
	31,747.07

[4] Of these amounts, the following sums are no longer in issue since they represent net increases in reserve accounts of the Southern Bank of Norfolk which taxpayer has conceded to be includible in income: Years ended January 31, 1952, $311.17; January 31, 1953, $278.05; January 31, 1954, $85.30, or a total of $674.52. (Colonial Chevrolet Tr. 13–14.)

Additional taxes and interest were assessed against taxpayer, which it paid; claims for refund were filed and rejected; and this suit for refund followed. The District Court overruled the deficiency determinations and entered judgment for the taxpayer in the total principal amount of $20,005.59 plus interest. (Colonial Chevrolet Tr. 14–15; Appendix A, *infra,* pp. 14, 16–17.) The Court of Appeals affirmed. (Appendix A, *infra,* pp. 17–18.)

Marine Chevrolet:

Taxpayer is a North Carolina corporation which, during the taxable years 1953–1955, inclusive, engaged in business as an automobile dealer, selling new and used automobiles on the installment basis. It kept its books and filed its returns on the accrual basis. It assigned (with full recourse) conditional sales contracts to the General Motors Acceptance Corporation (GMAC) pursuant to an agreement with that finance company. When a contract was assigned to GMAC by the taxpayer, taxpayer received from GMAC an amount in cash equal to the deferred portion of the cash price of the automobile. At that time GMAC credited to a repossession reserve account maintained on its books in taxpayer's name approximately 20% of a finance charge which was included in the total amount the purchaser was obligated to pay. (Appendix A, *infra,* pp. 18, 20–22.)

Payments are made by GMAC to dealers from the reserve account under different plans. Generally, GMAC retains a minimum in the reserve of 3% of a dealer's contingent liabilities. Some dealers are paid

periodically a portion of the amount credited by GMAC in excess of an agreed percentage of the total amount of outstanding paper. Payments were made to some dealers, including the taxpayer, only on the dealer's request that some part of the reserve be made available. The reserve account is debited when payments are made from it to the dealer, and the reserve account is also debited with a portion of the finance charge which is rebated to a customer if he pays a conditional sales contract before it is due. The reserve may also be debited for any unpaid liability of the dealer to GMAC. (Marine Chevrolet Tr. II, 76–77; Appendix A, *infra*, pp. 21–22.)

In case of default, GMAC normally repossesses the automobile and returns it to the taxpayer, who remits to GMAC the unpaid balance due under the conditional sales contract. (Marine Chevrolet, Ex. P–7.)

In November 1950, GMAC tendered taxpayer $3,800 in payment of a portion of the amount credited to taxpayer in GMAC's dealer reserve account. Taxpayer returned the check to GMAC requesting that it be credited back to its account. At that time there was $9,306 in the reserve, or 5.41% of taxpayer's total contingent liability to GMAC of $172,000. In July 1951, GMAC paid taxpayer $5,000 from the reserve, which reduced the credit in taxpayer's name to approximately 4% of taxpayer's total contingent liability to GMAC. From July 1951 to July 1956, including the taxable years here involved, GMAC made no payments to taxpayer from the reserve account, and taxpayer did not request the payment of any amounts. On July 27, 1956, GMAC paid tax-

payer $19,450 from the reserve account, pursuant to taxpayer's request. After this payment, GMAC retained approximately 6% of taxpayer's total contingent liability in the reserve. Mr. Leonard Graham, the manager of the Raleigh Branch of GMAC, testified that the $19,450 might have been paid earlier if taxpayer had requested it; that a portion of that sum definitely was available to the taxpayer before it was paid; and that, because of taxpayer's return of the check in 1950, GMAC held the reserve subject to taxpayer's request. (Marine Chevrolet Tr. II, 53, 76–77; Appendix A, *infra*, pp. 24–25.)

Taxpayer's balance sheets for the taxable years showed the following with respect to the reserve (Appendix A, *infra*, p. 24):

Fiscal year ended	Designation on balance sheet	Amount
July 31, 1953	Accrued commissions	$13,998.04
July 31, 1954	Accrued commissions	23,402.03
July 31, 1955	Dealer's reserve	33,041.02

The following table shows the accumulated credits to the taxpayer in the reserve account, the amount of taxpayer's total contingent liability to GMAC and the percentage relationship which the reserve bore to that total liability (Appendix A, *infra*, p. 24):

Date	Balance in plaintiff's dealer's reserve account	Amount of plaintiff's contingent liability	Percent of reserve of contingent liability
August 1951	$7,488	$178,000	4.21
August 1952	11,986	182,000	6.59
August 1953	20,495	350,000	5.85
August 1954	30,755	455,000	6.76
August 1955	55,252	894,000	6.18
August 1956	63,394	1,050,000	6.04

During each of the taxable years, taxpayer reported as "Other Income" the increase in the reserve in the following amount (Appendix A, *infra*, p. 23):

Fiscal year ended—	*Amount reported per return as other income*
July 31, 1953	$8,318.58
July 31, 1954	10,151.55
July 31, 1955	[1] 24,038.57

[1] Although this is the amount reported, Exhibit P-11 shows an increase in Repossession Reserve account of $24,013.57 for fiscal year 1955.

Claims for refund of such "Other Income" were filed for each of the taxable years, and suit was subsequently instituted to recover the same. (Appendix A, *infra*, pp. 19–20.) The District Court entered judgment for the taxpayer in the following amounts, plus interest (Appendix A, *infra*, pp. 27–29):

Fiscal year ended—	
July 31, 1953	$7,716.42
July 31, 1954	2,862.74
July 31, 1955	11,750.05
	22,329.21

REASONS FOR GRANTING THE WRIT

The question in these cases is the same as that presented in *Commissioner* v. *John R. Hansen and Shirley G. Hansen*, No. 380, this Term, in *Commissioner* v. *Burl P. Glover*, No. 381, this Term, and in *Clifton E. Baird and Violet L. Baird* v. *Commissioner*, No. 512, this Term, in which petitions for writs of certiorari were granted on November 10 and December 15, 1958.

The agreements between the taxpayer automobile dealers and the financing companies with which they dealt are in all substantial respects the same as the agreements involved in the above cases. As in

Hansen and *Glover,* the decisions below are in direct conflict with decisions of the Sixth and Seventh Circuits.[5] See *Schaeffer* v. *Commissioner,* 258 F. 2d 861 (C.A. 6th), petition for rehearing denied December 12, 1958; and *Baird* v. *Commissioner,* 256 F. 2d 918 (C.A. 7th), petition for certiorari granted December 15, 1958, No. 512, this Term, both of which are reprinted in Appendix C to the Commissioner's petition in *Hansen.* Writs having been granted in *Hansen, Glover,* and *Baird,* this Court will soon have occasion to decide the issue involved in the instant cases. We therefore believe it appropriate, in order to protect the Government's interests, to file a petition in these cases.

CONCLUSION

As was suggested in *United States* v. *Hine Pontiac, et al.,* No. 561, this Term, pending on petition for a writ of certiorari, the Court may wish to hold this petition in abeyance pending disposition on the merits in Nos. 380, 381 and 512.

Respectfully submitted.

J. LEE RANKIN,
Solicitor General.
CHARLES K. RICE,
Assistant Attorney General.
JOSEPH F. GOETTEN,
CAROLYN R. JUST,
Attorneys.

MARCH 1959.

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[5] As we noted in our petition in *Hansen,* the Tax Court has regularly sustained the Commissioner's position over a period of seventeen years. The Fourth, Fifth, Eighth and Ninth Circuits have ruled to the contrary.

APPENDIX A

Colonial Chevrolet

1. District Court's Findings of Fact and Conclusions of Law.

[Caption omitted]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause came on regularly to be heard by the Court sitting without a jury on the 26th day of June, 1958, and from the admissions in the pleadings, the stipulations of counsel and the evidence introduced at trial, the Court makes the following findings of fact and conclusions of laws:

FINDINGS OF FACT

1. During all the time herein concerned, the Plaintiff, Colonial Chevrolet Corporation, a Virginia corporation, was engaged in business in the City of Norfolk, Virginia, as a dealer in new and used automobiles and trucks, and kept its books and computed its tax liabilities on the accrual basis, using a fiscal year beginning on February 1 and ending on January 31.

2. This action arises under the Internal Revenue laws of the United States of America, and is an action for the recovery of Federal income and excess profits taxes and interest assessed against, and collected from, Plaintiff by the defendant for the taxable year ended January 31, 1951, and of Federal income taxes and interest assessed against, and collected from, Plaintiff by the defendant for the taxable years

ending January 31, 1952, January 31, 1953, and January 31, 1954.

3. Plaintiff duly and seasonably filed all the Federal income and excess profits tax returns required by law for each of the taxable years ended January 31, 1951, January 31, 1952, January 31, 1953, and January 31, 1954, and paid, when due, all the taxes shown thereon to be owing.

4. During each of said taxable years, plaintiff sold certain vehicles under conditional sales contracts (hereinafter referred to as "Contracts"), made by the respective purchasers to evidence and secure the deferred portion of the purchase price of said vehicles.

5. In each such sale, the purchaser first executed a purchase order describing the vehicle concerned and setting forth the proposed method of payment therefor. This order was not binding until accepted by Plaintiff, and was not accepted by Plaintiff unless and until the financing institution, to which the proposed contract was offered, agreed to finance the transaction. Upon receipt of the purchase order, Plaintiff submitted it, together with a financial statement relating to and furnished by the purchaser, to such financing institution. If the proposed contract was not acceptable to the financing institution, the proposed sale was not made. If the financing institution agreed to finance the transaction upon the condition that certain specified changes be made therein, the purchaser was so advised and unless the purchaser agreed to such changes, the transaction was not consummated. If the financing institution concerned agreed to finance the transaction, the sale was then consummated, using a conditional sales contract form furnished by such financing institution. Promptly after each sale was so consummated, Plaintiff assigned and

transferred the completed contract to the financing institution, and received therefor from such financing institution each in an amount equal to the deferred portion of the purchase price of the vehicle. In connection with each contract, a financing charge was imposed by the financing institution, which was shown on the face of the contract and included in the total amount the purchaser was obligated to pay.

6. At the time each contract was acquired by the financing institution, it credited to a reserve account maintained on its books in Plaintiff's name, a portion of the financing charge. The amounts so credited were subject to use only for the purposes and upon the conditions set out in the agreements between the Plaintiff and the respective financing institutions.

7. The financing institutions here concerned were General Motors Acceptance Corporation and National Bank of Commerce of Norfolk, the bulk of the financing being done by General Motors Acceptance Corporation.

8. Under the agreements between Plaintiff and the respective financing institutions, said reserve accounts could be used (to the extent necessary) for the purpose of absorbing and charging the losses and expenses incurred by the respective financing institutions in collecting the contracts acquired from Plaintiff. Plaintiff's rights in each of said reserve accounts were, accordingly, contingent and might never materialize.

9. In accordance with the agreements between Plaintiff and the respective financing institutions, which were in effect during the above-mentioned taxable years, if, on an annual specified date, the balance in the respective reserve account exceeded 3% of the total balances then outstanding on all contracts previously acquired from Plaintiff by the respective fi-

nancing institution, Plaintiff was then entitled to receive such excess. Plaintiff was not entitled to, and did not, receive or withdraw any other portion of said reserves on that date or on any other date.

10. Plaintiff did not establish or maintain on its books any reserve for losses relating to or connected with said contracts.

11. Plaintiff did not treat all or any part of said reserve accounts as an asset, nor was all or any part of said reserve accounts reflected in any way on Plaintiff's books or records (except only such part as Plaintiff was entitled to collect, which was reflected on Plaintiff's books when its right thereto became fixed).

12. In computing its taxes on income for each of the years here involved, Plaintiff included in its gross income all amounts which it received, or was entitled to receive, in respect of said reserve accounts, during such year, (but Plaintiff did not include in its gross income any other amounts of said reserve accounts).

13. Each such sale by Plaintiff involved the active participation of the financing institution which eventually received the contract connected therewith, and each such sale, beginning with the placing of the order by the purchaser and ending with the receipt of the contract by the financing institution and the payment by such financing institution to Plaintiff, constituted one integrated transaction among the three parties concerned.

14. Upon audit of Plaintiff's income and excess profits tax returns for the years herein concerned, the District Director of Internal Revenue at Richmond, Virginia, erroneously, improperly and illegally included in Plaintiff's income for each of such years, in addition to the amounts included by Plaintiff in

its returns, an amount equal to the net increase, during the respective years, in each of said reserve accounts.

15. As a result of such action by said District Director, the refund of taxes to which Plaintiff was entitled and for which Plaintiff properly and seasonably made claim, for the fiscal year ended January 31, 1951, was reduced, and additional income taxes and interest for each of the fiscal years ended January 31, 1952, January 31, 1953, and January 31, 1954, were assessed against and collected from Plaintiff.

16. The amounts of the taxes and interest erroneously, improperly and illegally assessed against and collected from Plaintiff by Defendant and the dates of payment thereof by Plaintiff are as follows:

Taxable year ended	Kind	Taxes amount	Interest	Total	Date of payment
Jan. 31, 1951	Income	$299 80			
	Excess profits	1,631 43		$1,931 23	$155.33 on 1/15/52, $144.47 on 10/24/55, $1,631.43 on 6/21/53.
Jan. 31, 1952	Income	4,361 78	$693 96	5,055 74	$1,380.16 on 2/20/52, $2,645.28 on 1/14/55, $883.40 on 10/24/55, $146.91 on 2/16/56.
Jan. 31, 1953	Income	4,681 04	851 48	5,532 52	5/10/56.
Jan. 31, 1954	Income	6,676 18	809 92	7,486 10	5/10/56.
	Total	$17,650 23	$2,355 76	$20,005 99	

17. Plaintiff duly and seasonably filed with said District Director of Internal Revenue proper refund claims for the aforesaid taxable years, all of which claims were rejected on or after February 18, 1957.

Conclusions of Law

1. This Court has jurisdiction of this case under Sections 1340, 1346(a)(1) and 1402, Title 28, U.S.C.A.

2. Amounts credited as aforesaid by General Motors Acceptance Corporation and National Bank of Commerce of Norfolk to reserve accounts carried on their respective books in the Plaintiff's name did not constitute taxable income to Plaintiff at the time such amounts were so credited, inasmuch as the Plaintiff's right to receive the same did not then become fixed.

3. "Until the right to an amount becomes accruable through the fixation of the right to receive, the taxpayer is under no obligation to return it as income."

4. Plaintiff was, accordingly, only required to include in its gross income for each taxable year, so much of each of said reserve accounts as Plaintiff received, or was entitled to receive, during such year (namely, such portion of said reserve accounts as was, on the designated date during such year in excess of 3% of the outstanding balances on all contracts then held by the respective financing institutions arising from sales of vehicles by Plaintiff).

5. Plaintiff is entitled to recover of and from Defendant the sum of $20,005.59, with interest on the sum of $155.33 from January 15, 1952, on the sum of $144.47 from October 24, 1955, on the sum of $1,631.43 from June 30, 1953, on the sum of $1,380.16 from February 21, 1955, on the sum of $883.40 from October 24, 1955, on the sum of $2,645.28 from October 14, 1955, on the sum of $146.91 from February 16, 1956, and on the sum of $13,018.62 from May 10, 1956, to a date preceding the date of the check issued in payment thereof by not more than thirty days, and together also with Plaintiff's costs allowed by law to be taxed against the Defendant, which sum, with interest as aforesaid, is due and owing by reason of the overassessments and

collections set out in paragraph 16 of the Findings of Fact.

(S) WALTER E. HOFFMAN,
United States District Judge.

NORFOLK, VIRGINIA,
September 3, 1958.

2. District Court's Judgment.

[Caption Omitted]

This cause having come on for trial before the Court without a jury on June 26, 1958, and the Court having considered the admissions in the pleadings, the stipulations of counsel and the evidence introduced at the trial, and the Court having entered its Findings of Fact and Conclusions of Law, it is hereby

ORDERED AND ADJUDGED that the plaintiff, Colonial Chevrolet Corporation, recover of and from the defendant, United States of America, the sum of $20,005.59, with interest on the sum of $155.33 from January 15, 1952, on the sum of $144.47 from October 24, 1955, on the sum of $1,631.43 from June 30, 1953, on the sum of $1,380.16 from February 21, 1955, on the sum of $883.40 from October 24, 1955, on the sum of $2,645.28 from October 14, 1955, on the sum of $146.91 from February 16, 1956, and on the sum of $13,018.62 from May 10, 1956, to a date preceding the date of the check issued in payment thereof by not more than thirty days, which sum, with interest as aforesaid, is due and owing as follows:

(*a*) For the taxable year ended January 31, 1951, the sum of $1,931.23, representing an overassessment of income tax in the amount of $299.80 and an overassessment of excess profits tax in the amount of $1,631.43;

(*b*) For the taxable year ended January 31, 1952, the sum of $5,055.74, representing on overassessment of income tax in the amount of $4,361.78 and an overpayment of interest thereon in the amount of $693.96;

(*c*) For the taxable year ended January 31, 1953, the sum of $5,532.52, representing an overassessment of income tax in the amount of $4,681.04 and an overpayment of interest thereon in the amount of $851.48; and

(*d*) For the taxable year ended January 31, 1954, the sum of $7,486.10, representing an overassessment of income tax in the amount of $6,676.18 and an overassessment of interest thereon in the amount of $809.92.

(S) WALTER E. HOFFMAN,
United States District Judge.

NORFOLK, VIRGINIA
September 3, 1958.

3. Judgment of the Court of Appeals.

[Caption Omitted].

At the request of the appellee in this proceeding, it appearing that the issue in this case is essentially the same as that decided by this Court on May 18, 1956, in *Blaine Johnson and Evelyn K. Johnson* v. *Commissioner*, 233 F. 2d 952; and

It further appearing that the parties to this proceeding desire to avoid further expense in connection with the appeal; and that the appellant is willing, without conceding the correctness of the appellee's position, that the case be disposed of without briefing and oral argument;

NOW THEREFORE IT IS ORDERED ADJUDGED AND DECREED that the judgment of the District Court entered in this cause on September 3,

1958, is hereby affirmed in accordance with this Court's opinion in *Johnson* v. *Commissioner, supra.*

SIMON E. SOBELOFF,
U.S.C. Judge.

MORRIS A. SOPER,
U.S.C. Judge.

CLEMENT F. HAYNSWORTH, JR.,
U.S.C. Judge.

Dated: *December 31, 1958*

Filed Jan. 5, 1959, R. M. F. Williams, Jr., Clerk.

Marine Chevrolet

1. District Court's Findings of Fact, Conclusions of Law and Memorandum Opinion.

[Caption omitted]

This action was brought to recover federal income taxes collected for the years ending July 31, 1953, July 31, 1954, and July 31, 1955, amounting to a total of $18,678.91, and was heard without a jury. A clear cut single question is presented: Was the net annual increase in the credit to a repossession reserve account maintained for plaintiff by General Motors Acceptance Corporation properly returned as income by the plaintiff in each of the years involved?

Upon evidence and the stipulations the Court finds these facts:

1. Plaintiff is a corporation organized and existing under the laws of the State of North Carolina and now maintains, and at all times hereinafter mentioned has maintained, its principal office at Jacksonville, Onslow County, North Carolina. Jacksonville, North Carolina, is a military area.

2. This action is brought against the United States of America for the recovery of Internal Revenue taxes for the fiscal years ended July 31, 1953, July 31, 1954, and July 31, 1955, which were collected for the United States of America by the District Director

of Internal Revenue for the District of North Carolina.

3. During all years material hereto plaintiff filed its United States Federal income tax returns on the basis of a fiscal year ended July 31, and in filing such returns and in keeping its books of account plaintiff employed an accrual method of accounting.

4. For the fiscal years ending July 31, 1953, July 31, 1954, and July 31, 1955, plaintiff timely filed its United States Federal income tax returns with the District Director of Internal Revenue for the District of North Carolina and disclosed thereon net income and income tax liability as follows:

Fiscal year ended	Net income per return	Tax liability per return
July 31, 1953	$44,393.05	$18,676.55
July 31, 1954	22,433.78	6,730.13
July 31, 1955	64,623.79	28,104.37

5. The tax liability disclosed on these returns was paid by plaintiff to the District Director of Internal Revenue for the District of North Carolina on dates as follows:

Fiscal year ended	Date of payment	Amount of payment	Total
July 31, 1953	Oct. 15, 1953	$7,470.62	
	Jan. 21, 1954	7,470.62	
	Apr. 15, 1954	1,867.66	
	July 15, 1954	1,867.65	$18,676.55
July 31, 1954	Oct. 20, 1954	3,028.56	
	Jan. 18, 1955	3,028.56	
	Apr. 14, 1955	336.51	
	July 14, 1955	336.50	6,730.13
July 31, 1955	Oct. 25, 1955	14,052.19	
	Jan. 16, 1956	14,052.18	28,104.37

6. On October 15, 1956, and within three years after the filing of each of the United States Federal income tax returns for the fiscal years ending July

31, 1953, July 31, 1954, and July 31, 1955, plaintiff timely filed with the Director of Internal Revenue for the District of North Carolina claims for refund of income tax for each of the fiscal years ending July 31, 1953, July 31, 1954, and July 31, 1955. Upon such claims plaintiff requested refunds of income tax for said years in the amount of $4,066.12, $2,862.74, and $11,750.05, respectively.

7. This action was instituted on May 6, 1957, which date is more than six months after such claims for refund were filed, and prior to the institution of this action the Commissioner of Internal Revenue had not notified plaintiff by registered mail of either the allowance or disallowance of said claims.

8. The Court is vested with jurisdiction in this action under Section 1346, Title 28, United States Code.

9. At all times pertinent herein plaintiff has engaged in business in Jacksonville as an authorized automobile dealer for Chevrolet, Oldsmobile and Cadillac cars, and in such business has handled primarily automotive products manufactured and distributed by General Motors Corporation. In its business about seventy percent of plaintiff's customers have been military or civil service personnel. A high percentage of all its business has been with individuals in the lower age group, that is, between 21 and 28.

10. In the ordinary course of its business plaintiff has sold both new and used automobiles on the installment basis, and notes regularly received for these sales have been assigned regularly to the General Motors Acceptance Corporation, hereinafter referred to as GMAC.

11. The acquisition of installment contracts from plaintiff during the taxable years 1953, 1954, and 1955 was handled by GMAC under its retail plan.

12. Under GMAC's retail plan, a finance charge is added to the amount to be collected from the automobile purchaser.

13. At the time of the purchase of a conditional sale contract by GMAC it credits a portion of the finance charge, approximately 20 percent, to an account (hereinafter called dealer's reserve account) in favor of the dealer from whom such contract is purchased.

14. Payments are made by GMAC to dealers from the dealer's reserve account under different plans. Payments are not made to some dealers until the dealer requests that some part of the reserve be made available. Other dealers are paid periodically a portion of the amount credited by GMAC to the particular dealer's reserve account.

15. The dealer's reserve account is debited with a portion of the finance charge which is rebated to a customer when a customer pays a conditional sale contract ahead of schedule. The dealer's reserve account is also debited when payments are made therefrom to the dealer.

16. At the election of GMAC the dealer's reserve account may also be debited for any unpaid liability of the dealer to GMAC.

17. When plaintiff sells an automobile to a purchaser who wishes to pay part of the purchase price in installments and the installment paper is to be assigned by plaintiff to GMAC, the purchaser and plaintiff execute a conditional sale contract upon a form furnished by GMAC, and this contract is for-

warded by plaintiff to GMAC for acceptance or rejection.

18. The contract so executed and forwarded sets forth the unpaid cash balance, insurance charges and the amount of the finance charge, the total of which constitutes the time balance.

19. As a prerequisite to acceptance of a conditional sale contract by GMAC plaintiff must execute an assignment and guaranty under the terms of which plaintiff unconditionally guarantees payment of the full amount at the contract and covenants if default be made in any payment due thereon to reimburse GMAC for the full amount of the unpaid balance due on the contract. GMAC will not purchase a contract unless the plaintiff's recommendation, assignment and guaranty is properly signed and executed by an official of the plaintiff.

20. If a conditional sale contract is accepted by GMAC it forwards plaintiff a check for the net proceeds of the contract, which is the cash selling price less the down payment.

21. After a contract is assigned to and accepted by GMAC it collects the installment payments and in the event of default by the purchaser of the automobile GMAC enforces responsibility against plaintiff in accordance with plaintiff's guaranty. This means that in the normal case GMAC repossesses the automobile from the defaulting purchaser and returns it to plaintiff. For its part plaintiff upon return of the car remits to GMAC the unpaid balance due under the conditional sale contract.

22. The dealer's reserve account in plaintiff's name on GMAC's books is controlled by GMAC. The amounts credited to the account are not available to plaintiff until GMAC elects to make payments therefrom.

23. GMAC will make no payment from the dealer's reserve account until it has considered the plaintiff's contingent liability on all conditional sales contracts assigned by plaintiff to GMAC. GMAC, prior to making payment, also considers the quality of the paper, the performance of the paper and the type of individual purchasers of cars primarily responsible under the conditional sales contracts.

24. GMAC makes payments to plaintiff of amounts credited to the dealer's reserve account only when it considers that the balance in the dealer's reserve account exceeds the amount required for its protection against loss on the conditional sales contracts acquired from plaintiff and for which plaintiff is contingently liable in event of default.

25. Approximately seventy percent of plaintiff's business was with military and civil service personnel attached to the Jacksonville Marine base. Plaintiff has many losses on its contracts and both plaintiff and GMAC consider the conditional sales contracts of military personnel more hazardous than average paper.

26. On plaintiff's books the dealer's reserve account was called "Repossession Reserve" account.

27. On its United States Federal income tax returns for the fiscal years ended July 31, 1953, July 31, 1954, and July 31, 1955, plaintiff reported as "Other Income" the amount of the increase in the account entitled "Repossession Reserve" on its books for each of the aforementioned years. The amounts so reported were as follows:

Fiscal year ended—	*Amount reported per return as other income*
July 31, 1953	$8,318.58
July 31, 1954	10,151.55
July 31, 1955	[1] 24,038.57

[1] Although this is amount reported Exhibit P–11 shows increase in Repossession Reserve account of $24,013.57 for fiscal year 1955.

28. The Repossession Reserve account was shown on plaintiff's balance sheets for fiscal years ended July 31, 1953, July 31, 1954, and July 31, 1955, as follows:

Fiscal year ended	Designation on balance sheet	Amount
July 31, 1953	Accrued commissions	$13,998.04
July 31, 1954	Accrued commissions	23,402.03
July 31, 1955	Dealer's reserve	33,941.02

29. The accumulated credits in the dealer's reserve account in plaintiff's name on GMAC's books, the amount of plaintiff's contingent liability on outstanding conditional sales contracts assigned to GMAC, and the percentage of the reserve to the contingent liability were as follows:

Date	Balance in plaintiff's dealer's reserve account	Amount of plaintiff's contingent liability	Percent of reserve of contingent liability
August 1951	$7,488	$178,000	4.21
August 1952	11,986	182,000	6.59
August 1953	20,495	350,000	5.85
August 1954	30,755	455,000	6.76
August 1955	55,252	894,000	6.18
August 1956	63,394	1,050,000	6.04

30. In November of 1950 GMAC tendered a payment to plaintiff of a portion of the amount credited to it in GMAC's dealer's reserve account. The amount tendered by check was $3,800, but the check was returned by the plaintiff with a request that the funds be credited back to its account. The amount was returned by plaintiff in order to build up a reserve account as protection against potential losses.

31. In November of 1950 plaintiff's contingent liability to GMAC was $172,000, and the accumulated credit in the dealer's reserve account in plaintiff's name on GMAC books was $9,306, or 5.41% of the contingent liability.

32. In July of 1951 GMAC made a payment of $5,000 to plaintiff and debited the dealer's reserve account in plaintiff's name by that amount. This payment reduced the credit in the dealer's reserve account in plaintiff's name to approximately four percent of plaintiff's contingent liability.

33. Between 1951 and 1956 no payments were made by GMAC to plaintiff which affected the credit in the dealer's reserve account in plaintiff's name on GMAC's books. Subsequent to July of 1951 until the latter part of July, 1956, the plaintiff did not request the payment of any amounts out of the dealer's reserve account in its name on GMAC's books and no withdrawals were made.

34. After July, 1951, the next payment by GMAC to plaintiff from the dealer's reserve account in plaintiff's name was in the amount of $19,450.00 in July of 1956. This payment was made pursuant to plaintiff's request. In making this payment in 1956 GMAC retained approximately six percent of plaintiff's contingent liability as a credit in the dealer's reserve account in plaintiff's name on GMAC's books.

35. Generally GMAC retains a minimum of three percent of a dealer's contingent liability as a credit in the dealer's reserve account in a dealer's name. At least that amount of credit must be accumulated before GMAC considers any reserve amount as being earned and payable. In some cases GMAC might require that less than three percent remain as a credit in the dealer's reserve account, but in many cases more than three percent is required as a minimum credit in such account.

36. GMAC could have retained 100 percent of the credit in the dealer's reserve account in plaintiff's name on GMAC's books if GMAC had so desired. In plaintiff's case GMAC would have retained as an

accumulated credit in plaintiff's dealer's reserve account an amount in excess of three percent of plaintiff's contingent liability. This amount in excess of three percent would have been required based upon GMAC's observation and knowledge of the hazardous type of risk involved in the conditional sales contracts assigned to it by plaintiff.

37. The right to receive the amounts in the dealer's reserve account in plaintiff's name on GMAC's books was not fixed in any of the taxable years 1953, 1954 and 1955.

38. The net annual increase in the credit to a dealer's reserve account maintained for plaintiff by GMAC, an automobile finance company, was not properly returned as income by plaintiff, an accrual basis taxpayer, in each of the years ended July 31, 1953, July 31, 1954, and July 31, 1955.

Upon the foregoing facts the Court concludes that the annual increase in the credit to the reserve account was improperly returned by plaintiff as income and that plaintiff should recover in accord with its demand.

It is contended by plaintiff that the decision in *Johnson* v. *Commissioner,* 233 F. 2d. 952 (4th Circuit) settles the question in its favor and with this position I agree. The efforts of the defendant to point out a substantial distinction between the Johnson case and this case are not persuasive. In *Long Poultry Farms, Inc.* v. *Commissioner,* —— F. 2d. ——, decided November 8, 1957, this Circuit reviewed and approved the position taken in the *Johnson* case, quoting as follows from the opinion in that case: "The general

principles which must control our decision have been authoritatively stated by the Supreme Court. It is 'the right to receive and not the actual receipt' of an amount which determines its accruability. 'When the right to receive an amount becomes fixed, the right accrues'. *Spring City Foundry Co.* v. *Commissioner*, 292 U.S. 182, 184, 185 * * *. Until the right to an amount becomes accruable through fixation of the right to receive, the taxpayer is under no obligation to return it as income. Otherwise, he would be required to pay a tax on income which he might never have a right to receive."

Several other decisions in point have been cited by the plaintiff, but there appears to be no good reason to deal with them as the *Johnson* case seems to me to end the argument in plaintiff's favor.

Plaintiff will present a formal judgment.

(S) DON GILLIAM,
United States District Judge.

2. District Court's Judgment.

[Caption omitted]

JUDGMENT

In accordance with the Court's findings of fact and conclusions of law filed on April 4, 1958, it is ordered, adjudged and decreed:

That the plaintiff recover from the defendant in overpayment of income tax for the taxable year ended July 31, 1953, in the amount of $7,716.42, together with interest as provided by law, and that, for interest computation purposes, the plaintiff has paid in-

come tax and interest for the taxable year ended July 31, 1953, in amounts and on dates as follows:

	Date	Income tax	Interest
Payments	Oct. 15, 1953	$7,470.62	
	Jan. 21, 1954	7,470.62	
	Apr. 15, 1954	1,867.66	
	July 15, 1954	1,867.65	
Total		18,676.55	
Less tentative carry-back refund		1,092.16	
Balance		17,584.39	
Payment	Dec. 17, 1956	14,999.57	$2,834.93
Net amount paid		32,583.96	2,834.93

That the plaintiff further recover from the defendant an overpayment of income tax for the taxable year ended July 31, 1954, in the amount of $2,862.74, together with interest as provided by law, and that, for interest computation purposes, the plaintiff has paid income tax and interest for the taxable year ended July 31, 1954, in amounts and on dates as follows:

	Date	Income tax	Interest
Payments	Oct. 20, 1954	$3,028.56	
	Jan. 18, 1955	3,028.56	
	Apr. 14, 1955	336.51	
	July 14, 1955	336.56	
	Dec. 17, 1956	442.69	$82.22
Total		7,172.89	82.22

That the plaintiff further recover from the defendant an overpayment of income tax for the taxable year ended July 31, 1955, in the amount of $11,750.05, together with interest as provided by law, and that, for interest computation purposes, the plaintiff has paid income tax and interest for the taxable year

ended July 31, 1955, in amounts and on dates as follows:

	Date	Income tax	Interest
Payments	Oct. 24, 1955	$14,052.19	
	Jan. 16, 1956	14,052.18	
	Dec. 17, 1956	2,238.92	$129.76
Total		30,343.29	129.76

That the plaintiff further recover from the defendant its costs as taxed by the Clerk.

This 25th day of June 1958.

(S) EDWIN M. STANLEY,
United States District Judge.

3. Judgment of the Court of Appeals.

[Caption Omitted]

At the request of the appellee in this proceeding, it appearing that the issue in this case is essentially the same as that decided by this Court on May 18, 1956, in *Blaine Johnson and Evelyn K. Johnson* v. *Commissioner,* 233 F. 2d 952; and

It further appearing that the parties to this proceeding desire to avoid further expense in connection with the appeal; and that the appellant is willing, without conceding the correctness of the appellee's position, that the case be disposed of without briefing and oral argument;

NOW THEREFORE IT IS ORDERED ADJUDGED AND DECREED that the judgment of the District Court entered in this cause on June 26, 1958,

is hereby affirmed in accordance with this Court's opinion in *Johnson* v. *Commissioner, supra.*

SIMON E. SOBELOFF,
Chief Judge, Fourth Circuit.
MORRIS A. SOPER,
United States Circuit Judge.
CLEMENT F. HAYNSWORTH, JR.,
United States Circuit Judge.

Dated: December 11, 1958
Filed Dec. 12, 1958, R. M. F. Williams, Jr., Clerk.

APPENDIX B

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 42 [as amended by Sec. 114, Revenue Act of 1941, c. 412, 55 Stat. 687]. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 42.)

Rev. Rul. 57-2, 1957-1 Cum. Bull. 17:

Amounts withheld by banks or finance companies to cover possible losses on notes purchased from dealers constitute income to dealers employing the accrual method of accounting, to the extent of their interest therein at the time the amounts are recorded on the books of the bank or finance company as a liability to the dealer, regardless of whether charges for worthless notes are also made to the account pursuant to an agreement between the parties. Losses sustained on worthless notes shall be separately established by the dealer as required by section 166 of the Internal Revenue Code of 1954.

The Internal Revenue Service has been requested to state its position with respect to the treatment, for Federal income tax purposes, of amounts withheld by banks and finance companies to cover possible losses on notes purchased from automobile or other dealers employing the accrual method of accounting, and which are recorded on the books of the bank or finance company as a liability of the bank or finance company to the dealer.

The steps generally involved in transactions concerning automobile dealers are as follows: When a car is purchased on credit from a

dealer, the purchaser makes a down-payment, either in the form of cash or by turning in another car at an agreed value, the balance being satisfied by the purchaser's promissory note and a supporting conditional sales contract. The face amount of the note reflects two elements—the balance of what would be the purchase price of the car, if bought for cash, and a finance charge. As between the purchaser and the dealer, the transaction is closed and completed at this point with the attendant tax consequences to the dealer.

It is then common practice for the dealer to sell or discount the purchaser's note and sales contract to some financial institution. The finance company or bank acquires the note at a value somewhat less than its face value, the difference representing a charge for its service. Simultaneously, either cash or unrestricted credit is given to the dealer to the extent of the amount reflected in the face value of the note that corresponds to the unpaid balance of the cash retail price of the car. The difference between the face value of the note and the sum of the finance company's charge and its credit or immediate payment to the dealer (representing part of the finance charge previously mentioned) is then credited on the books of the finance company as a liability of the finance company to the dealer. The accumulation of these credits is generally known as a "dealers reserve" and is the specific object of the present consideration.

Settlement of the liability represented by the reserve is subject to agreement between the particular dealer and the financial institution involved. In some instances, the agreement does not contemplate the charging of any items against the reserve account, while in others the account reflects a running record of various transactions between the parties, that is, both credits and charges are entered,

depending upon the nature of the item. Thus, in certain instances, the dealer and the finance company may agree that notes purchased or discounted are to be charged to the reserve account in the event they become worthless.

With regard to those instances where losses incurred by a finance company on notes purchased from automobile dealers may not be charged against the reserve, the credits to the reserve, by the finance company in favor of a dealer who employs the accrual method of accounting constitute income to the dealer at the time such credit is made, even though the dealer is not immediately or even currently able to draw on the entire reserve. See G.C.M. 9571, C. B. X–2, 153 (1931), and *Shoemaker-Nash, Inc.* v. *Commissioner,* 41 B. T. A. 417. The principles involved in the purchase of notes from automobile dealers by banks or finance companies as described above are equally applicable where notes are purchased, under similar conditions, from dealers in items other than automobiles.

Where a dealer's reserve is in the nature of a running account, the charging thereto of worthless notes pursuant to agreement between the parties has no bearing upon the fact that taxable income has been received by the dealer, or upon the time of its realization as otherwise evidenced by the credits to such reserve.

Accordingly, it is held that credits to such reserve, in the case of a dealer employing the accrual method of accounting, constitute income to the dealer at the time such credits are made regardless of whether charges to the account for worthless notes are also made pursuant to an agreement between the parties. Losses sustained on worthless notes are to be separately established by the dealer as required by the provisions of section 166 of the Internal Revenue Code of 1954 relating to bad debts.

In arriving at these conclusions, consideration has been given the case of *Blaine Johnson et al.* v. *United States,* 233 Fed. (2d) 952. See also, *Albert M. Brodsky et ux.* v. *Commissioner,* 27 T.C. No. 23.

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